

City of Shakopee
Communications Letter
December 31, 2016



**City of Shakopee
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**Report on Matters Identified as a Result of
the Audit of the Financial Statements**

Honorable Mayor, Members
of the City Council and Management
City of Shakopee
Shakopee, Minnesota

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Shakopee, Minnesota, as of and for the year ended December 31, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error, or fraud may occur and not be detected by such controls. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



The accompanying memorandum also includes financial analysis provided as a basis for discussion. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated May 18, 2017, on such statements.

This communication is intended solely for the information and use of the City Council, management, others within the City and state oversight agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Bergan KDV, Ltd.

St. Cloud, Minnesota
May 18, 2017

City of Shakopee Required Communication

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2016. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA AND GOVERNMENT AUDITING STANDARDS

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Generally accepted accounting principles provide for certain required supplementary information (RSI) to supplement the basic financial statements. Our responsibility with respect to the RSI, which supplement(s) the basic audit financial statements, is to apply certain limited procedures in accordance with generally accepted auditing standards. However, the RSI was not audited and, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance, we do not express an opinion or provide any assurance on the RSI.

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

PLANNED SCOPE AND TIMING OF THE AUDIT

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the City, or to acts by management or employees acting on behalf of the City.

City of Shakopee Required Communication

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in the notes to financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2016. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

Depreciation – The City is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.

Expense/Expenditure Allocation – The City is currently allocating certain costs among the programs and supporting services benefited. The costs are allocated based on management's estimates.

Net Other Post Employment Benefits (OPEB) Obligation– This liability is based on an actuarial study using estimates of future obligations of the City for post-employment benefits.

Net Pension Liability, Deferred Outflows of Resources Relating to Pension Activity, and Deferred Inflows of Resources relating to Pension Activity – These balances are based on an allocation by the pension plans using estimates based on contributions.

We evaluated the key factors and assumptions used to develop the accounting estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. We identified the following uncorrected misstatement(s) of the financial statements. Management has determined its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole:

- Government-Wide State Aid for PEPFF Contribution

**City of Shakopee
Required Communication**

CORRECTED AND UNCORRECTED MISSTATEMENTS (CONTINUED)

In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

MANAGEMENT REPRESENTATIONS

We requested certain representations from management that are included in the management representation letter.

MANAGEMENT CONSULTATIONS WITH OTHER ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

We applied certain limited procedures to the RSI that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

**City of Shakopee
Required Communication**

OTHER MATTERS (CONTINUED)

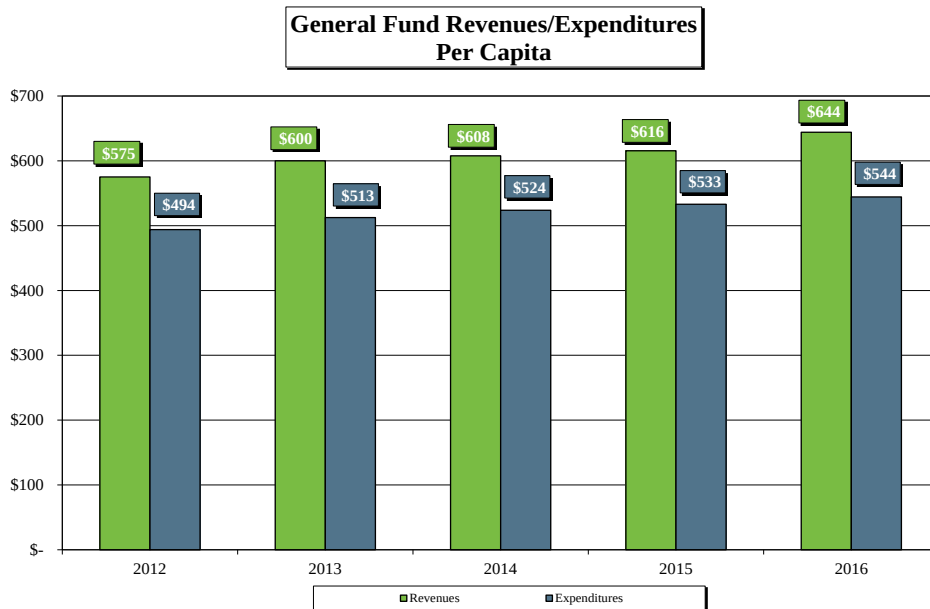
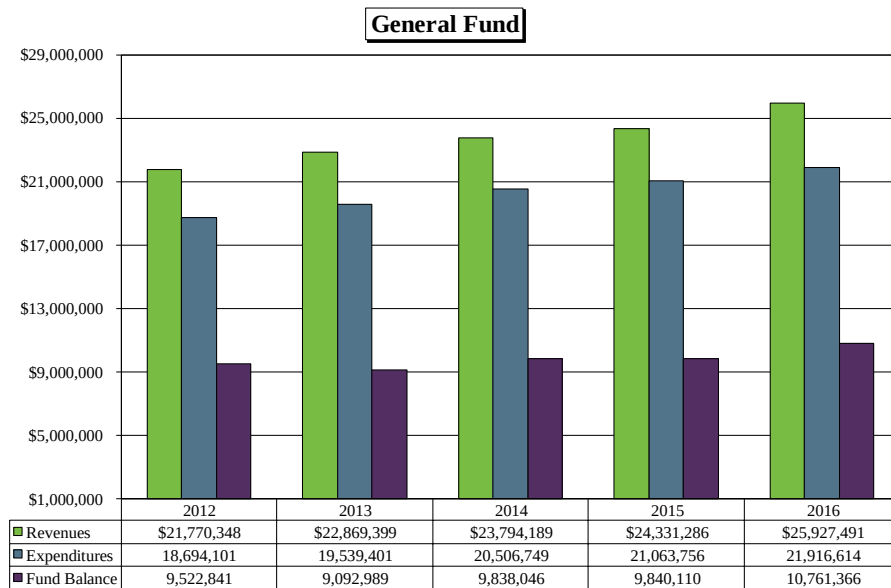
With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

City of Shakopee Financial Analysis

The following pages provide graphic representation of select data pertaining to the financial position and operations of the City for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance.

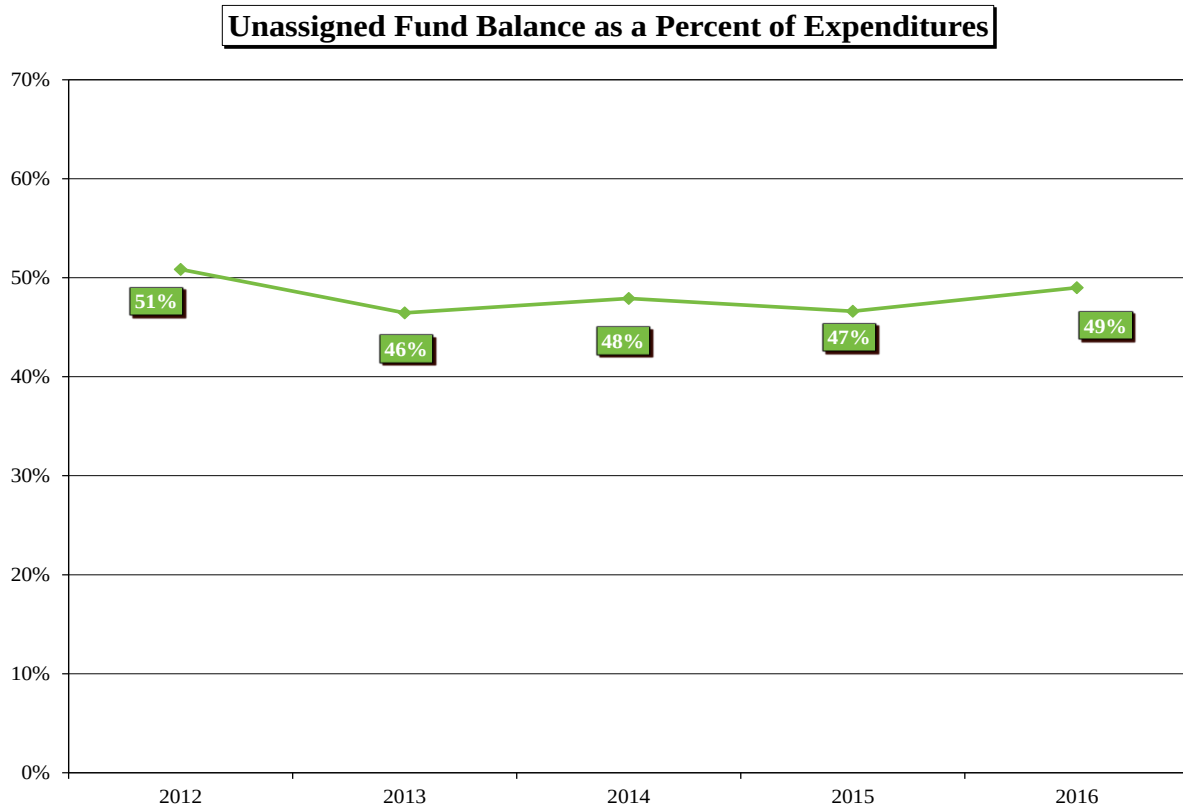
GENERAL FUND OPERATIONS OF THE CITY

For the year ended December 31, 2016, revenues and transfers in exceeded expenditures and transfers out. Total fund balance in the General Fund increased \$921,256, or 9.4%, in 2016 to \$10,761,366.



**City of Shakopee
Financial Analysis**

GENERAL FUND OPERATIONS OF THE CITY (CONTINUED)



The City's target General Fund balance is an unassigned level between 40% (minimum) and 45% of expenditures. This level is to provide working capital for cash flow, expected decline in revenues and unforeseen expenditures such as natural disasters. Replenishing the Fund balance when it falls below the target level shall be accomplished by interfund transfers or budgeting for expenditures and other uses to be less than revenues or other sources over a period not to exceed three years. For the year ended December 31, 2016, the City maintained an unassigned fund balance of 49% of current year expenditures. The City also evaluates the unassigned fund balance as a percentage of the next years budgeted expenditures. Based on the 2017 budget the City has an unassigned fund balance of 44.3%.

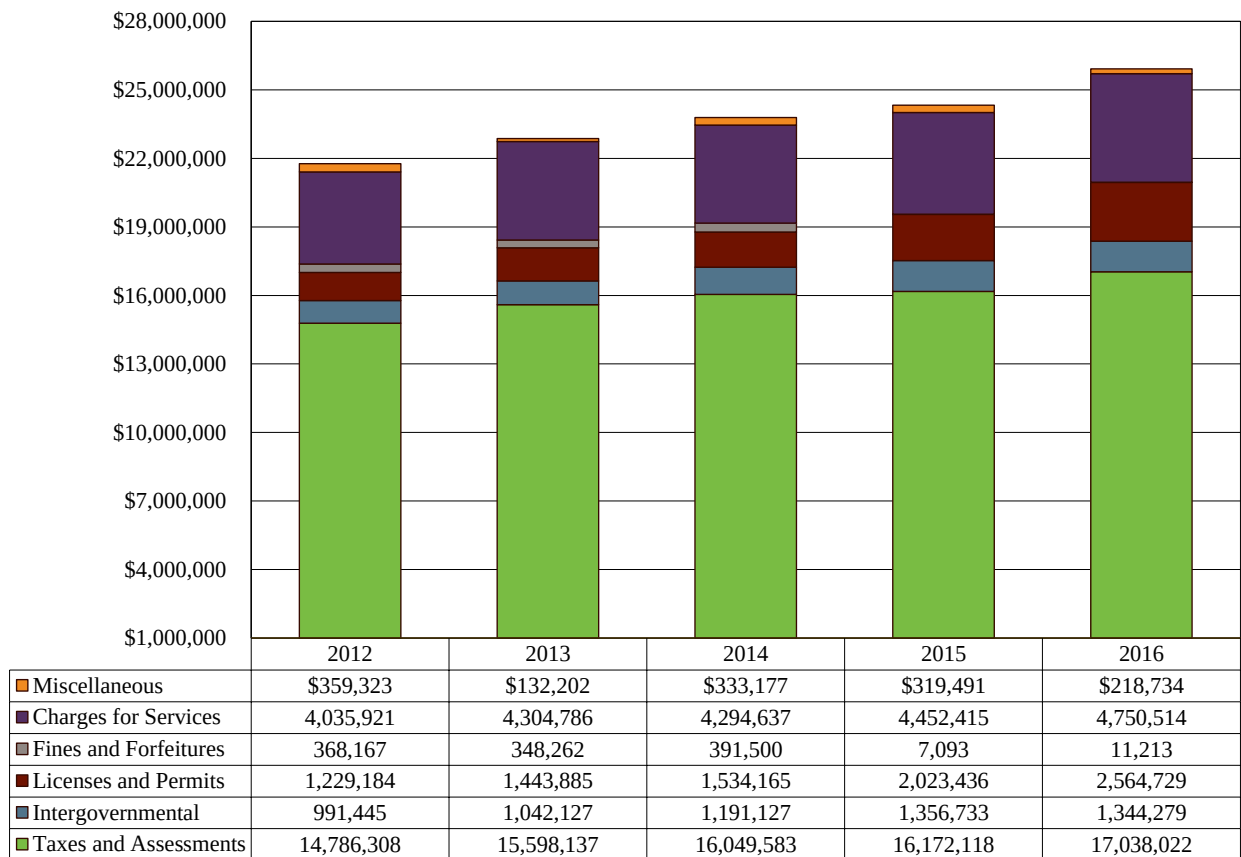
City of Shakopee Financial Analysis

GENERAL FUND REVENUES

The City's revenue in the General Fund has increased each of the last five years. During 2016, revenue in the General Fund exceeded the prior year revenue by \$1,596,205, increasing from \$24,331,286 to \$25,927,491. Property taxes increased due to an increase in the General Fund levy of approximately \$688,000, as well as increased delinquency collections, and a number of tax petitions in 2015 which had reduced revenue. Licenses and permits increased \$541,000 due to increased development within the City. Charges for services increased \$298,000 with increased police contracted services and new arena advertising and increased memberships. All other revenues were consistent with the prior year.

During 2016, property taxes represented 66% of the total General Fund revenues. Charges for services represented the second largest component at 18%.

General Fund Revenues

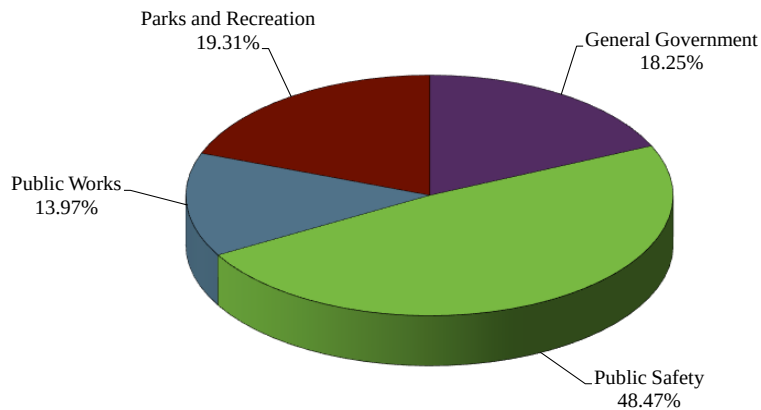


City of Shakopee Financial Analysis

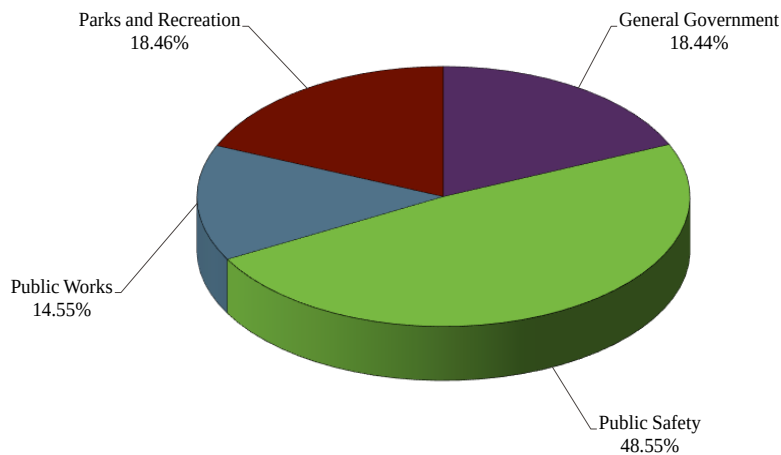
GENERAL FUND EXPENDITURES

In 2016, total General Fund expenditures increased \$852,858, or 4.0%, from \$21,063,756 in 2015 to \$21,916,614 in 2016. Public safety increased \$396,031 as a result of salary and benefit increases, and additional employees. Recreation increased \$315,098 due to changes in staffing levels, pay increases, and increased electric costs with the new arena. General government and public works were consistent with prior year amounts.

2016 General Fund Expenditures



2015 General Fund Expenditures



City of Shakopee Financial Analysis

GENERAL FUND OPERATIONS OF THE CITY

For the 2016 operating year, the City Council provided a revised budget that would increase the General Fund balance by \$453,710. Revenues and expenditures exceeded expectations, resulting in both being over budget. At year-end, revenues and transfers in exceeded expenditures and transfers out by \$921,256.

	Budget	Actual	Variance
Revenues			
Taxes and assessments	\$ 17,162,400	\$ 17,038,022	\$ (124,378)
Licenses and permits	2,269,100	2,564,729	295,629
Intergovernmental	1,251,900	1,344,279	92,379
Charges for services	4,368,150	4,750,514	382,364
Fines and forfeitures	1,500	11,213	9,713
Miscellaneous revenues	207,750	218,734	10,984
Total revenues	\$ 25,260,800	\$ 25,927,491	\$ 666,691
Expenditures			
General government	\$ 4,096,290	\$ 3,999,953	\$ (96,337)
Public safety	10,417,100	10,623,322	206,222
Public works	2,965,440	3,061,172	95,732
Parks and recreation	4,233,860	4,232,167	(1,693)
Total expenditures	\$ 21,712,690	\$ 21,916,614	\$ 203,924
Proceeds from sale of capital asset	\$ 600	\$ 9,134	\$ 8,534
Transfers in	250,000	250,000	-
Transfers out	(3,345,000)	(3,348,755)	(3,755)
Total other financing Sources (uses)	(3,094,400)	(3,089,621)	4,779
Change in fund balance	\$ 453,710	\$ 921,256	\$ 467,546

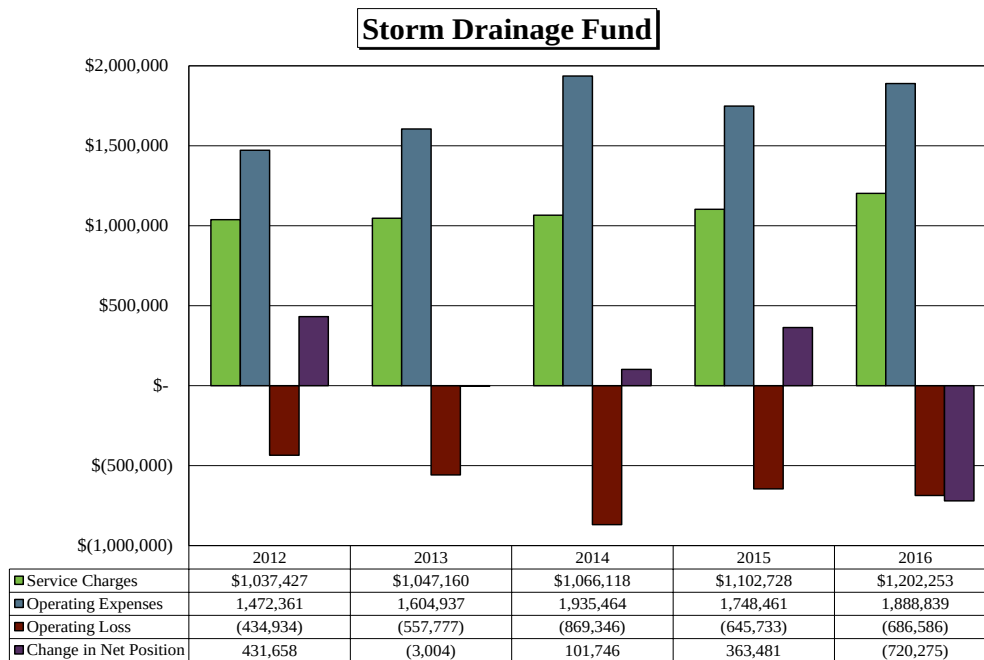
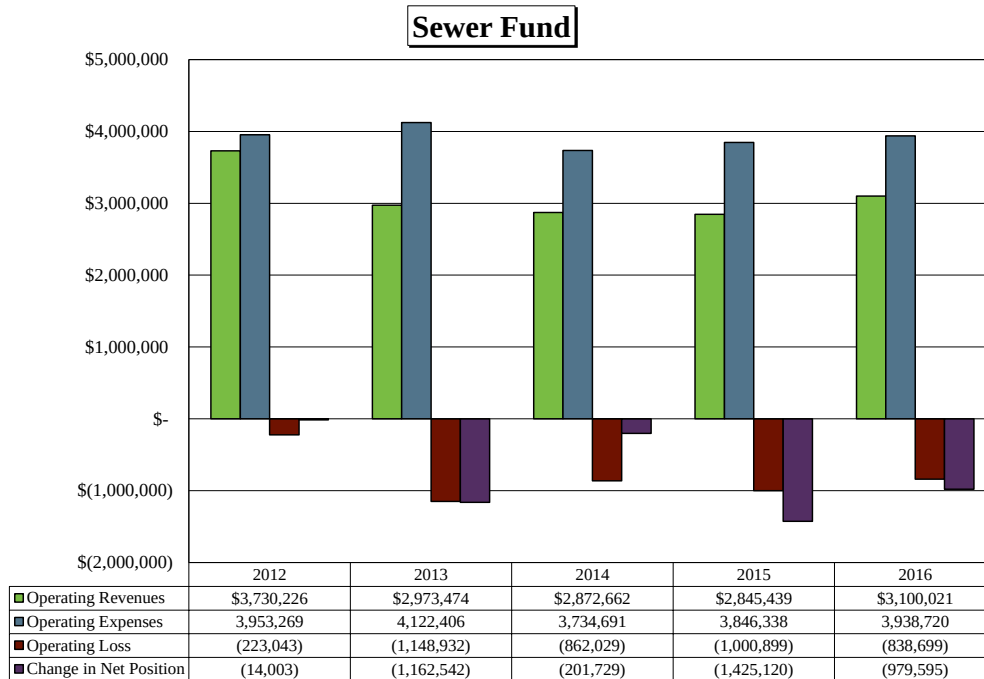
During 2016, revenue in the General Fund exceeded the budget by \$666,691, or 2.6%. Significant revenue budget variances are a result of conservative budgeting for revenues that can fluctuate during the year, such as licenses, permits and engineering fees. Charges for services were over the revised budget due to increased contracts for police services and engineering fees for developments that exceeded the amounts anticipated at the time the budget was revised.

Expenditures exceeded budgeted amounts by \$203,924, or 0.9%. Public safety was over budget due to increased compensated absences that were not included in the budget, as well as the purchase of new software for building inspections that was not budgeted. All other functions were consistent with budgeted amounts.

City of Shakopee Financial Analysis

ENTERPRISE FUNDS

The City has three enterprise funds. The following charts compare the segment information and net position of the Sewer and Storm Drainage enterprise funds for the last five years.

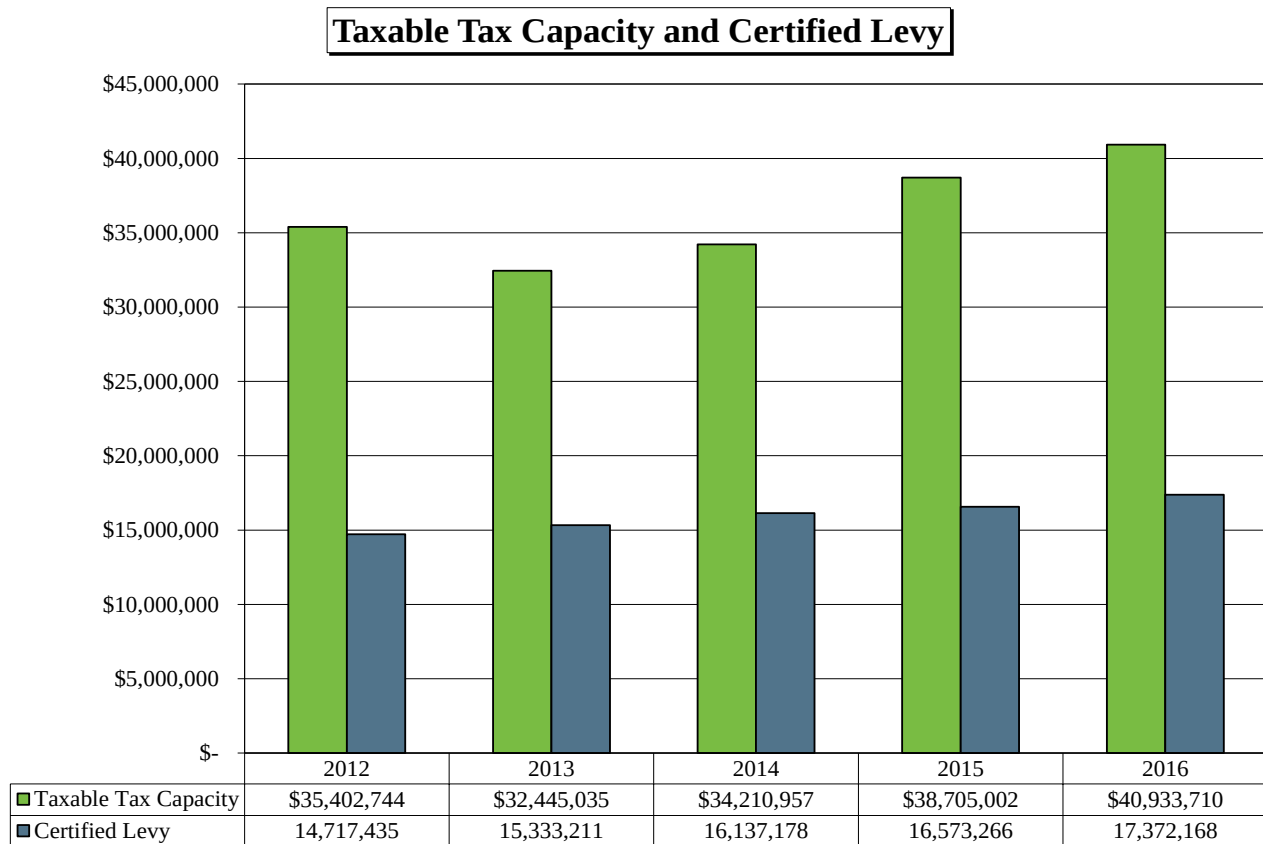


During 2016, the Sewer and Storm Drainage Funds both had operating losses. The Funds have reported an operating loss for the past five years. This is primarily due to the depreciation expense in both Funds.

City of Shakopee Financial Analysis

TAX LEVY, CAPACITY, AND RATES

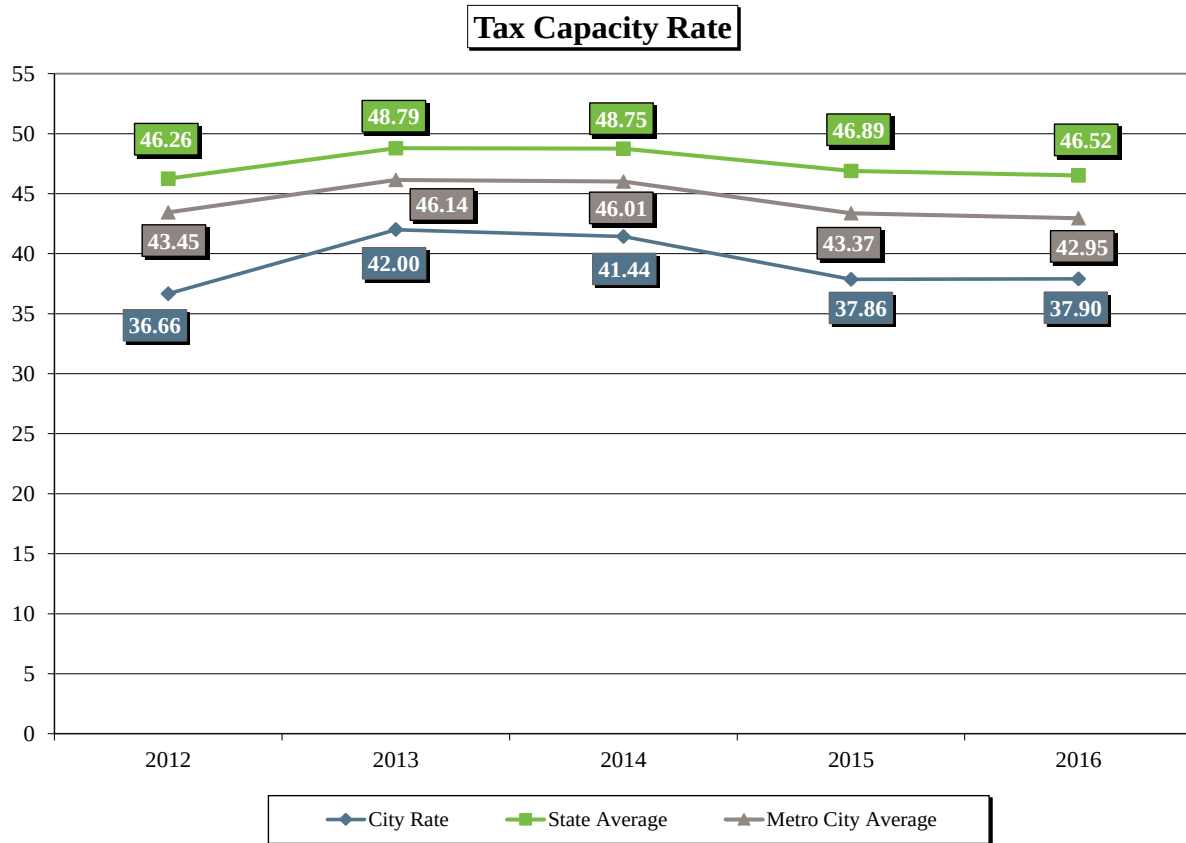
The 2014 through 2016 levies include the General Fund and debt service levies. The tax levy is then reduced by fiscal disparity credit that is received in the form of state aid. Disparity aid is reported as tax revenue and reduces the amount of property tax revenue levied upon the City.



* Tax capacity values and levy obtained from the League of Minnesota Cities.

City of Shakopee Financial Analysis

TAX LEVY, CAPACITY, AND RATES (CONTINUED)



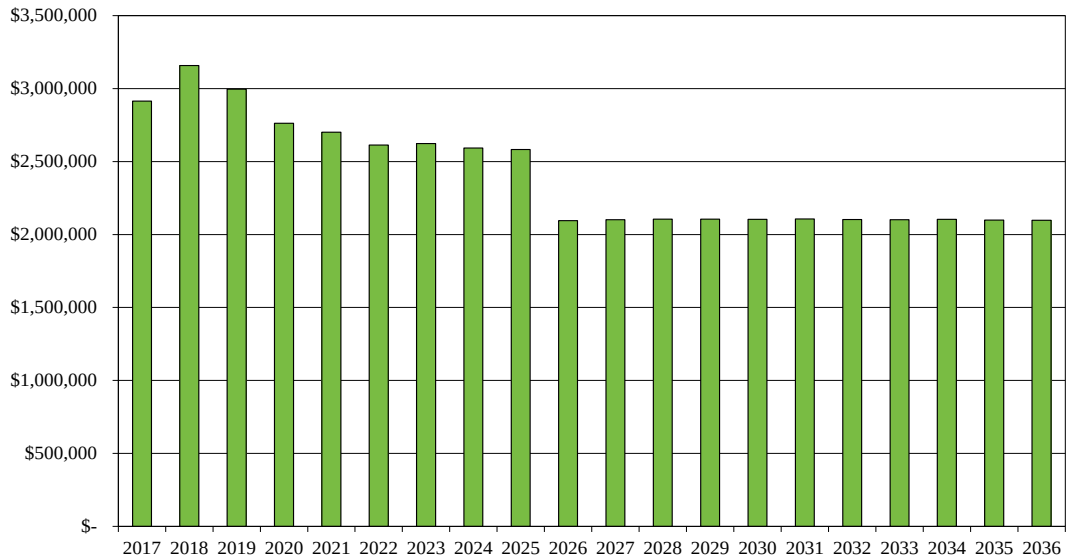
* Tax rates obtained from the League of Minnesota Cities.

City of Shakopee Financial Analysis

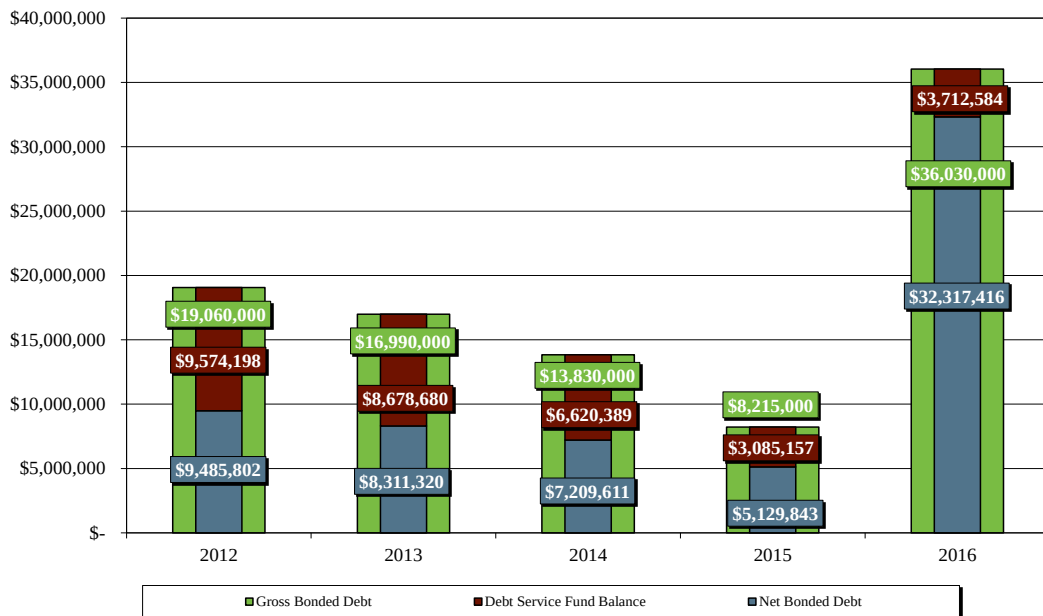
DEBT SERVICE

The following charts illustrate debt service requirements, including principal and interest through 2036 and bonded debt for the last five years.

Debt Service Schedule



Bonded General Obligation Debt



City of Shakopee Emerging Issues

Executive Summary

The following is an executive summary of financial and business related updates to assist you in staying current on emerging issues in accounting and finance. This summary will give you a preview of the new standards that have been recently issued and what is on the horizon for the near future. The most recent and significant updates include:

- **Accounting Standard Update – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions** – Governmental Accounting Standards Board (GASB) has issued GASB statement 75 relating to accounting and financial reporting for postemployment benefits other than pensions. The new statement requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities.

The following are extensive summaries of each of the current updates. As your continued business partner, we are committed to keeping you informed of new and emerging issues. We are happy to discuss these issues with you further and their applicability to your City.

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 75 - ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

The primary objective of this statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

GASB Statement 75 requires governments to report a liability on the face of the financial statements for the OPEB that they provide:

- Governments that are responsible only for OPEB liabilities related to their own employees and that provide OPEB through a defined benefit OPEB plan administered through a trust that meets specified criteria will report a *net OPEB liability*—the difference between the total OPEB liability and assets accumulated in the trust and restricted to making benefit payments.

**City of Shakopee
Emerging Issues**

ACCOUNTING STANDARD UPDATE – GASB STATEMENT NO. 75 - ACCOUNTING AND FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

- Governments that participate in a cost-sharing OPEB plan that is administered through a trust that meets the specified criteria will report a liability equal to their *proportionate share of the collective OPEB liability* for all entities participating in the cost-sharing plan.
- Governments that do not provide OPEB through a trust that meets specified criteria will report the *total OPEB liability* related to their employees.

GASB Statement 75 carries forward from Statement 45 the option to use a specified alternative measurement method in place of an actuarial valuation for purposes of determining the total OPEB liability for benefits provided through OPEB plans in which there are fewer than 100 plan members (active and inactive). This option was retained in order to reduce costs for smaller governments.

GASB Statement 75 requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities. Among the new note disclosures is a description of the effect on the reported OPEB liability of using a discount rate and a healthcare cost trend rate that are one percentage point higher and one percentage point lower than assumed by the government. The new RSI includes a schedule showing the causes of increases and decreases in the OPEB liability and a schedule comparing a government's actual OPEB contributions to its contribution requirements.

Information provided above was obtained from www.gasb.org.